

The Honorable Fred Van Sickle

STEVE W. BERMAN, WSBA No. 12536  
ERIN K. FLORY, WSBA No. 16631  
HAGENS BERMAN SOBOL SHAPIRO LLP  
1918 8th Avenue, Suite 3300  
Seattle, WA 98101-2609  
(206) 623-7292

BRADLEY B. JONES, WSBA No. 17197  
KENNETH G. KIEFFER, WSBA No. 10850  
F. MIKE SHAFFER, WSBA No. 18669  
GORDON THOMAS HONEYWELL  
MALANCA PETERSON & DAHEIM LLP  
1201 Pacific Avenue, Suite 2100  
Tacoma, WA 98402  
(253) 620-6500

UNITED STATES DISTRICT COURT  
EASTERN DISTRICT OF WASHINGTON  
AT SPOKANE

In re METROPOLITAN SECURITIES  
LITIGATION

No. CV-04-0025-FVS

THIS DOCUMENT RELATES TO:  
ALL ACTIONS

PLAINTIFFS' MEMORANDUM  
IN SUPPORT OF MOTION *IN*  
*LIMINE* TO EXCLUDE  
ARGUMENT REGARDING SEC  
"APPROVAL" OF 2000  
FINANCIALS

Hearing Date: March 3, 2010  
Time: 9:00 a.m.

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## I. INTRODUCTION

As the Court is aware from prior motion practice, one of the central issues in this case is the extent to which SEC comment-letters dated from October 2002 to October 2003 regarding concerns over accounting issues prevented Metropolitan and Summit from selling new securities, thereby plunging the companies into an irreversible liquidity crisis. Plaintiffs also allege that accounting issues raised by the SEC in those letters were the same issues Plaintiffs have indentified as misstatements on the 2000 financials.

PricewaterhouseCoopers (“PwC”) has made clear that it intends to argue at trial that because the SEC had previously approved registration statements that contained the 2000 financials, that constitutes a seal of approval by the SEC, and is evidence demonstrating that the accounting on the 2000 financials was correct and that PwC therefore audited those financials correctly. In fact, they have even offered an expert on the issue, Jennifer Bethel, who is subject to a pending *Daubert* motion. However, any such argument is expressly forbidden by applicable law, and by common sense, and should not be allowed at trial. To allow such argument and testimony would violate the law, create undue prejudice, and mislead and confuse the jury.

## II. EVIDENCE AT ISSUE IN THIS MOTION

PwC has designated as exhibits several letters from 2001 and 2002 between the SEC and Metropolitan and Summit regarding various registration statements which incorporated the 2000 financials audited by PwC. The registration statements at issue were deemed effective, in some cases after no comments from the SEC, in other cases after very few comments. Those letters – and argument

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1 and expert testimony about them – is what this motion is about.

### 2 III. ARGUMENT

3 Congress has specifically drafted two applicable statutes which go so far as  
4 to make it *unlawful* for anyone to even imply that an SEC review of a financial  
5 statement or registration statement constitutes a conclusion that the SEC deemed  
6 that statement to be complete and accurate. In 15 U.S.C. § 77w, Congress  
7 specifically addressed the SEC's review of registration statements:  
8

9 Neither the fact that the registration statement for a security has been  
10 filed or is in effect nor the fact that a stop order is not in effect with  
11 respect thereto shall be deemed a finding by the [SEC] that the  
12 registration statement is true and accurate on its face or that it does not  
13 contain an untrue statement of fact or omit to state a material fact, or  
14 be held to mean that the [SEC] has in any way passed upon the merits  
of, or given approval to, such security. It shall be unlawful to make, or  
cause to be made, to any prospective purchaser any representation  
contrary to the foregoing provisions of this section.

15 An extremely similar provision, at 15 U.S.C. § 78z, is even broader:

16 no action or failure to act by the [SEC] ... shall be construed to mean  
17 that [the SEC] has in any way passed upon the merits of, or given  
18 approval to, any security ..., nor shall such action or failure to act  
19 with regard to any statement or report filed [with the SEC] ... be  
20 deemed a finding by [the SEC] such statement is true and accurate on  
21 its face or that it is not false or misleading. It shall be unlawful to  
make, or cause to be made, to any prospective purchaser or seller of a  
security any representation that any such action or failure to act by  
any such authority is to be construed.

22 The law could scarcely be clearer, then, that PwC cannot argue, imply, or  
23 intimate that the SEC gave a stamp of approval to the 2000 financials. Allowing  
24 PwC to stand up at trial and argue or suggest otherwise to the jury would create a  
25 serious risk of misleading or confusing the jury as the relevant facts and law. If  
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PwC has an alternate theory of the relevance of these documents, they might be admissible for that purpose, but they cannot be used to suggest that the SEC had somehow blessed the 2000 financials by not digging in deeply to the accounting on those financials prior to October 2002. This evidence, any related argument, should not be allowed under Fed. R. Evid. 402 and 403.<sup>1</sup>

PwC, in its responses to objections to exhibits, has attempted to claim that it will not run afoul of these prohibitions because it does not intend to offer evidence that the SEC made a “finding” that the 2000 financials were accurate. Instead, PwC claims, it can make the following arguments:

- That “the SEC’s 2001 inquiry ... is probative of whether those transactions were properly accounted for in Metropolitan’s FY 2000 financials.” Ct. Rec. 1003, p. 40.
- That the evidence is “probative of whether audit evidence reviewed and relied on was sufficient ....” *Id.*

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<sup>1</sup> While the statutes make clear the prohibition on arguing the SEC’s approval constitutes evidence of the validity or correctness of a financial statement, those statutes do not preclude Plaintiffs from arguing that the SEC’s concerns over accounting matters in 2002 and 2003 demonstrate a causal link between the alleged misstatement and Plaintiffs’ damages. Plaintiffs are not arguing that the SEC found the 2000 financials to be in error, but rather that the SEC raised questions about the same accounting policies that Plaintiffs alleged resulted in material misstatements, thereby causing a liquidity crisis which resulted from the SEC’s failure to approve new securities.

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- That the evidence is “probative of ... whether the SEC’s alleged foot-dragging in 2003 was motivated by concerns about the FLIP and Koa.” *Id.* at 41.<sup>2</sup>
- That the evidence is “probative of ... whether Metropolitan’s FY 2000 accounting for FLIP and Koa was appropriate.” *Id.*
- That the evidence is “probative of ... whether the audit evidence was relied upon by PwC was sufficient.” *Id.*
- That the evidence is “probative of ... whether the SEC was concerned about that FY 2000 accounting years later in 2003.” *Id.*

However, PwC’s attempts at circumventing the law simply beg the question – *how is what the SEC did or did not do in earlier proceedings probative of any of these “facts” if the SEC did not issue a “finding” as to the accuracy of the 2000 financials?* To take a specific example, the earlier SEC process cannot be “probative” of “whether ... transactions were properly accounted for in Metropolitan’s FY 2000 financials” because the SEC review cannot be deemed a “finding” as to the accuracy of those financials. Since the SEC cannot be deemed to have made that finding, whether the SEC deemed those earlier registration statements effective is irrelevant to the question of whether the financials are accurate. No matter how PwC twists its description of the supposed relevance of

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<sup>2</sup> To be clear, Plaintiffs are not “alleging” that the SEC “dragged its feet,” nor are they arguing about the SEC’s “motivation.” Plaintiffs will demonstrate, using the face of the SEC’s 2002 and 2003 letters, that for an entire year the SEC was asking questions about issues that are directly related to the alleged misrepresentations in the 2000 financials. The SEC’s intent is not at issue.

1 its argument, PwC simply cannot avoid the fact that its use of this evidence will be  
2 to either directly state or imply that the SEC had issued such a finding.<sup>3</sup>

3 In addition, Plaintiffs note that the restriction on the use of SEC action or  
4 inaction as evidence of approval of financials or a registration statement simply  
5 results from common sense. The SEC is not an auditor – that was PwC’s role. The  
6 SEC, as a practical matter, does not have the ability or the resources to flyspeck or  
7 re-audit every financial statement filed by every public company in the United  
8 States, much less every registration statement filed by a relatively insignificant  
9 company such as Metropolitan Mortgage. In the spring of 2002 (the same time  
10 period during which PwC claims the SEC was giving a thumbs-up to 2000  
11 financials), the U.S. General Accounting Office reported as follows to Congress  
12 regarding its findings on SEC operations and workload:

13 U.S. securities markets have grown tremendously and  
14 become more complex and international. As a result,  
15 SEC’s workload has increased in volume and complexity  
16 over the past decade. [A]round 1996, SEC’s workload  
17 (e.g., filing, applications, and examinations) started to  
increase at a much higher rate than SEC staff years  
devoted to this workload. ....

18 SEC Operations: Increased Workload Creates Challenges, at second page (not  
19 numbered). See [www.gao.gov/cgi-bin/getrpt?GAO-02-302](http://www.gao.gov/cgi-bin/getrpt?GAO-02-302). As also stated in the  
20 same report:

21 \_\_\_\_\_  
22 <sup>3</sup> PwC has cited one case it believes supports its argument, *Union Pac. R.R. Co.*  
23 *v. Chicago & Northern Western R.R. Co.*, 226 F. Supp. 400, 406 (N.D. Ill. 1964).  
24 However, an honest reading of the case reveals that the case does not touch on  
25 these issues but instead was apparently discussing a private party’s standing to sue  
26 where the SEC has already acted.

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SEC and industry officials said SEC's ability to fulfill its mission has become increasingly strained due in part to imbalances between SEC's workload ... and staff resources. ... [L]imited resources have forced SEC to be selective in its enforcement activities .... [C]ertain filings were subject to less frequent and less complete reviews as workloads increased.

*Id.* at 11-12. It is precisely these sorts of hard realities about the SEC's ability to review filings, and its need to allocate limited resources to a nearly boundless workload, that makes it so dangerous and improper to argue or imply that SEC review of a financial statement constitutes a conclusion that the statement is accurate and in compliance with GAAP or that the auditors did their jobs correctly. The law makes such representations unlawful to for a reason. PwC should not be allowed to present such an argument, directly or indirectly, at trial.

#### IV. CONCLUSION

For the foregoing reasons, Plaintiffs request that the Court preclude PwC from arguing, or introducing evidence for the purpose of demonstrating, that the SEC approved of the accounting or auditing underlying Metropolitan and Summit's 2000 financial statements.

Dated this 16th day of February, 2010.

HAGENS BERMAN SOBOL SHAPIRO LLP

By /s/ Tyler S. Weaver

Steve W. Berman, WSBA No. 12536

Erin K. Flory, WSBA No. 16631

Tyler S. Weaver, WSBA No. 29413

Jeniphr Breckenridge, WSBA No. 21410

1918 8th Avenue, Suite 3300

Seattle, WA 98101

Telephone: (206) 623-7292

Facsimile: (206) 623-0594

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1 F. Mike Shaffer, WSBA No. 18669  
2 Bradley B. Jones, WSBA No. 17197  
3 Kenneth G. Kieffer, WSBA No. 10850  
4 GORDON, THOMAS HONEYWELL,  
MALANCA, PETERSON & DAHEIM LLP  
5 1201 Pacific Avenue, Suite 2100  
6 Tacoma, WA 98402  
7 Telephone: (253) 620-6500  
Facsimile: (253) 620-6565

8 *Co-Lead Counsel for Plaintiffs*  
9  
10  
11  
12  
13  
14  
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**CERTIFICATE OF SERVICE**

I hereby certify that a true copy of the above document was served upon the attorney of record for each other party via email on February 16, 2010 to the following:

George S. Azadian [Azadian@strook.com](mailto:Azadian@strook.com)

James K Barbee at [jim@golbeckroth.com](mailto:jim@golbeckroth.com)

Philip S Beck at [anne.doyle@bartlit-beck.com](mailto:anne.doyle@bartlit-beck.com); [susan.dandrea@bartlit-beck.com](mailto:susan.dandrea@bartlit-beck.com)

Ronald L Berenstein at [rberenstein@perkinscoie.com](mailto:rberenstein@perkinscoie.com); [jstarr@perkinscoie.com](mailto:jstarr@perkinscoie.com)

Steve W Berman at [steve@hbsslaw.com](mailto:steve@hbsslaw.com); [heatherw@hbsslaw.com](mailto:heatherw@hbsslaw.com)

Brian D Buckley at [bbuckley@fenwick.com](mailto:bbuckley@fenwick.com)

Elizabeth J Cabraser at [ecabraser@lchb.com](mailto:ecabraser@lchb.com); [ewalser@lchb.com](mailto:ewalser@lchb.com)

Kelly P Corr at [kcorr@correronin.com](mailto:kcorr@correronin.com); [dpatterson@correronin.com](mailto:dpatterson@correronin.com); [reception@correronin.com](mailto:reception@correronin.com)

Pearl Del Rosario at [pdelrosario@orrick.com](mailto:pdelrosario@orrick.com); [valdeman@orrick.com](mailto:valdeman@orrick.com)

Christopher G Emch at [emchc@foster.com](mailto:emchc@foster.com); [pateb@foster.com](mailto:pateb@foster.com)

Timothy L Filer at [filet@foster.com](mailto:filet@foster.com); [howej@foster.com](mailto:howej@foster.com)

Steven Fogg at [sfogg@correronin.com](mailto:sfogg@correronin.com); [ivandiver@correronin.com](mailto:ivandiver@correronin.com)

E Joseph Giometti at [jgiometti@orrick.com](mailto:jgiometti@orrick.com); [gjohnson@orrick.com](mailto:gjohnson@orrick.com)

Peter Jennings Grabicki at [pjg@randanco.com](mailto:pjg@randanco.com); [scc@randanco.com](mailto:scc@randanco.com); [nlg@randanco.com](mailto:nlg@randanco.com)

Gary I Grenley at [ggrenley@grebb.com](mailto:ggrenley@grebb.com)

Richard M Heimann at [rheimann@lchb.com](mailto:rheimann@lchb.com); [lsimms@lchb.com](mailto:lsimms@lchb.com)

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1 Kenneth P Herzinger at [kherzinger@orrick.com](mailto:kherzinger@orrick.com)  
2 David D Hoff at [dhoff@tousley.com](mailto:dhoff@tousley.com); [btaylor@tousley.com](mailto:btaylor@tousley.com)  
3 Tarek Ismail at [tarek.ismail@bartlit-beck.com](mailto:tarek.ismail@bartlit-beck.com); [anne.doyle@bartlit-beck.com](mailto:anne.doyle@bartlit-beck.com)  
4 Stephen M Knaster at [sknaster@orrick.com](mailto:sknaster@orrick.com); [vadelman@orrick.com](mailto:vadelman@orrick.com)  
5 James B. King at [jking@ecl-law.com](mailto:jking@ecl-law.com)  
6 Christopher D Landgraff at [chris.landgraff@bartlit-beck.com](mailto:chris.landgraff@bartlit-beck.com)  
7 Mary D Manesis at [mmanesis@stroock.com](mailto:mmanesis@stroock.com); [cdusi@stroock.com](mailto:cdusi@stroock.com)  
8 J Scott McBride at [scott.mcbride@bartlit-beck.com](mailto:scott.mcbride@bartlit-beck.com)  
9 James P McNeill, III at [mcnej@foster.com](mailto:mcnej@foster.com)  
10 Michael L Merriman at [michael.merriman@bartlit-beck.com](mailto:michael.merriman@bartlit-beck.com)  
11 Jeffrey S Miller at [milje@foster.com](mailto:milje@foster.com); [kellie@foster.com](mailto:kellie@foster.com); [snydd@foster.com](mailto:snydd@foster.com);  
12 [hickc@foster.com](mailto:hickc@foster.com)  
13 John Degnan Munding at [munding@crumb-munding.com](mailto:munding@crumb-munding.com); [brittany@crumb-](mailto:brittany@crumb-munding.com)  
14 [munding.com](mailto:munding.com)  
15 Robert J Nelson at [rnelson@lchb.com](mailto:rnelson@lchb.com)  
16 Kevin Daniel O'Rourke at [korourke@southwellorourke.com](mailto:korourke@southwellorourke.com)  
17 Carl J Oreskovich at [carl@ettermcmahon.com](mailto:carl@ettermcmahon.com); [roni@ettermcmahon.com](mailto:roni@ettermcmahon.com)  
18 Erin K. Flory at [erin@hbsslaw.com](mailto:erin@hbsslaw.com); [carrie@hbsslaw.com](mailto:carrie@hbsslaw.com)  
19 Andrew K Polovin at [andrew.polovin@bartlit-beck.com](mailto:andrew.polovin@bartlit-beck.com);  
20 [anne.doyle@bartlit-beck.com](mailto:anne.doyle@bartlit-beck.com)  
21 Terry J Price at [tprice@rmalw.com](mailto:tprice@rmalw.com)  
22 Mark Roth at [mark@golbeckroth.com](mailto:mark@golbeckroth.com)  
23 Stephen M Rummage at [steverummage@dwt.com](mailto:steverummage@dwt.com); [jeannecadley@dwt.com](mailto:jeannecadley@dwt.com)  
24  
25  
26

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1 Darrell W Scott at [scottgroup@mac.com](mailto:scottgroup@mac.com); [ssimatos@mac.com](mailto:ssimatos@mac.com)

2 M Todd Scott at [tscott@orrick.com](mailto:tscott@orrick.com); [jwatts@orrick.com](mailto:jwatts@orrick.com); [tmanolova@orrick.com](mailto:tmanolova@orrick.com)

3 James M Shaker at [shaker@ryanlaw.com](mailto:shaker@ryanlaw.com); [callahan@ryanlaw.com](mailto:callahan@ryanlaw.com)

4 Daniel F Shea at [dfshea@hhlaw.com](mailto:dfshea@hhlaw.com);

5 Kim D Stephens at [kstephens@tousley.com](mailto:kstephens@tousley.com); [efile@tousley.com](mailto:efile@tousley.com);  
6 [jalbertson@tousley.com](mailto:jalbertson@tousley.com)

7 Julia B Strickland at [jstrickland@stroock.com](mailto:jstrickland@stroock.com); [tmitchell@stroock.com](mailto:tmitchell@stroock.com);  
8 [lacalendar@stroock.com](mailto:lacalendar@stroock.com)

9 Earl M Sutherland at [esutherland@rmlaw.com](mailto:esutherland@rmlaw.com); [lfisher@rmlaw.com](mailto:lfisher@rmlaw.com)

10 Beth E Terrell at [bterrell@tousley.com](mailto:bterrell@tousley.com); [bkinsey@tousley.com](mailto:bkinsey@tousley.com); [efile@tousley.com](mailto:efile@tousley.com)

11 Paul H Trincherro at [ptrincherro@grebb.com](mailto:ptrincherro@grebb.com)

12 Michael C Tu at [mtu@orrick.com](mailto:mtu@orrick.com); [sspencer@orrick.com](mailto:sspencer@orrick.com)

13 Robert P Varian at [rvarian@orrick.com](mailto:rvarian@orrick.com)

14 Fabrice Vincent at [fvincent@lchb.com](mailto:fvincent@lchb.com); [dclevenger@lchb.com](mailto:dclevenger@lchb.com)

15 Joshua Watts at [jwatts@orrick.com](mailto:jwatts@orrick.com); [gjohnson@orrick.com](mailto:gjohnson@orrick.com)

16 Christine Marie Weaver at [cw@cweaverlaw.com](mailto:cw@cweaverlaw.com)

17 Leslie Richard Weatherhead at [lwlibertas@aol.com](mailto:lwlibertas@aol.com)

18 Charles S Wright at [charleswright@dwt.com](mailto:charleswright@dwt.com); [terriray@dwt.com](mailto:terriray@dwt.com)

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21  
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HAGENS BERMAN SOBOL SHAPIRO LLP

By s/ Tyler S. Weaver

Tyler S. Weaver, WSBA No. 29413

1918 8<sup>th</sup> Avenue, Suite 3300

Seattle, WA 98101

Telephone: (206) 623-7292

Facsimile: (206) 623-0594

*Co-Lead Counsel for Plaintiffs*

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